A Self-Evaluation Guide To Starting a Business Of Your Own

Stage 2

FINDING AND EVALUATING A PRODUCT OR SERVICE IDEA

Manitoba
Industry,
Trade
and Tourism

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I
Introduction

In stage 1 of this series you had an opportunity to evaluate your own potential for an entrepreneurial career from the standpoint of your personal fit with the requirements for success as an entrepreneur, the business skills required to start and run a business of your own and the adequacy of your financial resources. Assuming that you feel you have the "right stuff" to continue to explore this career option Stage 2 will enable you to identify and evaluate a number of ideas upon which to base your new venture.

This publication describes a number of sources from which you might obtain ideas for a prospective new venture and presents a variety of techniques that you can use to evaluate the conceptual, technical and financial aspects of your business idea.

Manitoba Industry, Trade and Tourism thanks Dr. Walter Good, of G. & B. Research Associates, for the preparation of this booklet. Complete packages of this self-evaluation guide consisting of three booklets are available for a nominal charge from:

STATEMENT:

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II

Long-Term Expectations For Your Business

Whether your plans are to own and operate a business for a number of years or sell it shortly after it becomes operational you will want to consider the long-term prospects of your venture. If you plan to keepthe business you are bound to have an interest in how it is expected to prosper and if your plans are to sell the business then the prospective buyer will consider the long-term viability of the business in his purchase offer. So, either way, the long-term performance—the kind of firm your business may become—is important in evaluating various alternatives. Opportunities with higher growth potential generally offer greater economic payoffs. However, those are not the only kind of payoffs that are important to the small businessman. Some small but stable ventures provide very enjoyable situations and lucrative benefits to their owners.

For the purpose of assessing the expected long-term prospects of your venture three types of possibilities should be considered: (1) lifestyle ventures, (2) small profitable ventures, and (3) high-growth ventures.

1. Lifestyle Ventures

These include most "one-man shows," Mom 'n Pop stores, and other lifestyle businesses such as gas stations, restaurants , dry cleaning shops, and small independent retail stores. Typically, their owners make modest investments in fixed assets and inventory, put in long hours, and earn considerably less income than the average unskilled auto worker or union craftsman. The upside potential in reselling these businesses tends to be quite low.

The operator of a lifestyle business often risks his savings to capitalize the enterprise, and works longer hours with less job security and lower pay than the average employee. Most lifestyle businesses have a high risk of failure. Unless you are willing to put up with these inherent conditions, such types of businesses should probably be avoided in favour of staying with your job until a more attractive opportunity can be identified.

2. Small, Profitable Ventures

Many small manufacturing firms, larger restaurants and retail firms, small chains of gas stations, and other multiestablishment enterprises commonly fall in this category. Usually they involve a substantial capital investment—from $100,000 on up. Some owners put in long hours, while others do not. Once established many owners enjoy a comfortable living. Upside potential in reselling the business can be high to a buyer who sees both an attractive job and a profitable investment.

You might be surprised at how many small, virtually unnoticeable businesses around your city or town have managed to provide a very comfortable living to their founders. Almost always there is a very particular reason that they are able to do so: a contract the entrepreneur was able to land at favorable terms, or a market that was unknown to others or toc small to attract competitors which, therefore, permitted a high profit margin, or special skills or knowledge on the part of the proprietor which enabled him to charge high rates for his time. The business's advantage may be a particular location, perhaps purchased for a low price many years earlier, or a patented process that others are not able to copy. It can even be simply a brand that is protected by trademark and which has become well known over the years or through successful advertising.

3. High-Growth Ventures

Much rarer than either of the abvove two, but typically more highly publicized, are small firms that have the capability of becoming large ones. They include many high-technology companies that are formed around new products with large potential markets, and also some of the small, profitable firms which, due to such factors as having amassed substantial capital or having hit upon a successful formula for operating, can be expanded many times. Ventures of this type are often bought up and absorbed by larger companies. The potential for significant capital gains on resale of the business can be substantial.

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A key factor in starting a high growth venture is choosing the right industry to enter. The rate of growth of the industry as a whole often plays a large role in determining the growth patterns of new startups within it. In addition, however, there has to be some property of the business that can readily be multiplied by that company but cannot easily be duplicated by others for there to be significant high-growth potential. In franchising, for example, it can be a format for doing business which has proven itself exceptionally effective and can be taught to others. In high technology firms, it is specialized knowhow in creating something at a hard-to-reach frontier of engineering for which there is a demand. If a technology is common knowledge and not too capital-intensive, then companies providing it generally do not grow very rapidly.

III

Sources of Ideas for a New Business

Where to Look for New Business Ideas

In Stage 1 it was suggested that your previous jobs, hobbies, personal experiences, and the like, could provide you with some of the requisite business and technical skills needed to operate your own business. Similarly, your past work experience, hobbies, and acquaintances can provide a starting point for developing a list of business ventures you might wish to consider for further investigation. The following is a brief description of some of the sources most often used by entrepreneurs in search of new business opportunities.

1. Ideas from Your Previous Employment

Most ideas for new business ventures result from jobs formerly held by an aspiring entrepreneur. One study found that 20 percent of the business startups reported were simply restarted companies by former employers who had run into trouble. Another recent study indicated that 60 percent of the entrepreneurs surveyed had started their new enterprise in an industry that was directly related to their last job.

The attractions of starting a business in a field in which you have experience and expertise are quite obvious: knowledge of current products and services offered, understanding the competitive environment, knowledge of customer needs, and so on.

2. Ideas from Hobbies and Travel

While hobbies may offer a lot of fascination and considerable attraction as potential ventures to consider, there can be a lot of conflict between a hobby and a successful business. Hobbies, typically, are activities that you are willing and prepared to do at your own expense. This can exert a downward pressure on the likely profitability of your venture. Margins are often very low in such things as model building, arts and crafts, trading in stamps and coins small-scale farming, antique car restoration, and various types of sporting activities. Nevertheless, profitable venture ideas can often emerge from this source.

Whenever you travel, look for new business opportunities. Many products and services you see being offered may not yet have been introduced into the Canadian market, or, at least, not into Manitoba or another local market you are contemplating entering. You may be able to negotiate exclusive or some other form of distribution rights for that product. You may even want to duplicate the product or service yourself, as long as you do not infringe on any legal rights that the original owner might have.

3. Ideas from Friends, Acquaintances, and Social Encounters

Friends are generally a bountiful source of ideas. Advise them of your interest in looking for specific product or service opportunities. When you are at a social function, ask people what they do for a living. If they are in a business, ask them questions about the business, such as why they got started, what their future plans are, where they see a need in the market, and what they enjoy about owning their own business.

Think of all the people you know socially. If any of them work in your area of interest, take them to lunch and ask them about their business.

4. Product Licensing Information Services

An excellent way to obtain information about the vast number of new product ideas available from inventors, corporations, or universities is to subscribe to a service that periodically publishes data on products offered for licensing. Licensing means renting the right to manufacture or distribute a product within agreed rules or guidelines. For example, you might purchase the right to manufacture tee-shirts and sweaters with the logo of Garfield the Cat or other popular fictional characters or use the trademark of a popular product such as Coca-Cola on similar apparel. The owner of the license retains ownership and receives a royalty or fixed fee from you as the licensee. There are a number of information services which you can contact to locate product or service licensing opportunities. These sources include:

Licensing Opportunities Section,
Business Centre,
Department of Industry, Science & Technology,
Government of Canada,
Ottawa, Ontario
K1A 0H5

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Government Inventions Available for Licensing,
National Technical Information Service (NTIS),
P.O. Box 1533,
Springfield, Virginia 22151

Technology Mart,
Thomas Publishing Company,
250 West 34th Street,
New York, New York 10001

5. Ideas from Personal Observation

Occasionally the idea for a new product or service results from keen observation of daily living situations. The following examples illustrate this point.

—The idea for "Q-Tips" hit Leo Gerstenzany when he noticed his wife's efforts to wrap cotton on toothpicks to clean their baby daughter's ears.

—The idea for the automatic toaster hit Charles Strite when he got mad at the burnt toast in the plant lunchroom of the factory where he worked as a mechanic.

6. Ideas from Business Publications and Other Sources

There are a number of business publications and other sources which can provide ideas that might stimulate your entrepreneurial thinking.

—*Newspapers and Magazines*: The Globe and Mail, the Financial Post and the Financial Times offer classified secitons which provide a listing or make other reference to available small business opportunities. A number of Canadian magazines such as Canadian Business, Small Business Magazine and Your Money and U.S. publications such as Inc., Venture, and Entrepreneur, provide further descriptions of a range of business possibilities.

—*Newsletters*: There are thousands of newsletters available covering almost every conceivable subject. The information they contain is current and specialized, and can provide invaluable access to opportunities in any field. For further information, contact the reference librarian at your public library, and ask for the *National Directory of Newsletters and Reporting Services* (Gale Research Company, Book Tower, Detroit, Michigan, 48226). It lists every major publication.

—*Trade Publications*: A list of available trade publications can be obtained from *Canadian Advertising Rates and Data*, (481 University Avenue, Toronto, Ontario, M5W 1A7) or similar publications available in most libraries. Trade magazines are usually the first to publicize a new product. In many cases the manufacturer is looking for help in distributing a new line. The ads will also provide information about potential competitors and their products. These trade publications are some of the best sources of data about a specific industry, and frequently print market surveys, forecasts, and articles on needs the industry may have. All this information can serve as a stimulating source of ideas.

—*Inventor's Shows/Trade Shows/Conventions*: These shows enable inventors and manufacturers to meet together to put new products on the market. There are major inventor shows held annually in the larger cities throughout Canada and the United States. Information on upcoming shows may be available from the Chamber of Commerce in these cities or contact the Office of Inventions and Innovations, National Bureau of Standards, Washington, D.C., 20234, for a list of the major inventor shows held throughout the United States.

Trade shows covering the industry you want to enter can also be an excellent way to examine the products and services of many of your potential competitors, serve as a vehicle for you to meet distributors and sales representatives, learn of product and market trends, and identify potential products or services for your venture. Trade shows usually take place several times a year in various locations. You will find trade show information in the trade magazines servicing your particular field or industry, or you may refer to the following sources:

—*Exhibits Schedule: Annual Directory of Trade and Industry Shows*, Exhibit Designers and Producers Association, 521 Fifth Avenue, New York, N.Y., 10017

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— *Trade Show Convention Guide*, Budd Publications, 228 E. 45th St., New York, N.Y., 10017

— *Canadian Industry Shows and Exhibitions*, Box 9100, Station A, Toronto, Ontario, M5W 1V7

Conventions are also an excellent place to stimulate your creative thinking. At a convention you are exposed to panels, speakers, films, and exhibitions. You also have an opportunity to exchange ideas with other people attending. Information on conventions and meetings scheduled to take place around the world can be obtained from:

— *Directory of Conventions*, Successful Meetings Magazine, 1422 Chestnut Street, Philadelphia, PA, 19102

— *World Meetings: U.S. and Canada*, World Meetings Information Center, Macmillan Information Corp., 866 Third Avenue, New York, N.Y. 10022

— *Government Agencies*
The Federal Business Development Bank (FBDB) as well as various provincial government agencies such as the Business Resource Centre are in business to help entrepreneurs with business management seminars and courses, advice, information, and other help. You may also obtain feedback on the viability of your business idea as well as obtain new ideas. The cost in most cases is nominal.

There are numerous other provincial government agencies that have publications and resources available to stimulate ideas for new business opportunities. Your public library can provide you with further information on all the government departments relevant to your area of interest, and how to get on free mailing lists, or government source lists for the goods or services that you may want to provide.

The range of sources of business ideas discussed here is certainly not exhaustive. Through careful observation, enthusiastic inquiry, and systematic search, it is possible to uncover a number of areas of potential business opportunities. However, once those sources are discovered a further process of evaluation and analysis of those ideas must take place.

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Generating Ideas for a New Business

A number of techniques have been developed to help prospective entrepreneurs generate viable business ideas for their new venture. These techniques complement the sources of ideas discussed in the previous section. Several of these methods are presented below.

1. The Use of Notebooks and Idea-Boards

One method which may help you generate ideas is to express any idea you may have in some kind of visual fashion. By placing some "visual figure" representing an idea or opportunity where you will constantly see it, you will subconsciously begin to develop it and other ideas related to it.

To use the concept of a visual idea board for your own business idea, you can start with a bulletin board of any reasonable size. All you have to do is to write your central business theme in the middle of the board, and add other material to that idea as thoughts pop into your mind. Additions can be anything visual such as hand-printed slogans, newspaper clippings, magazine and newspaper pictures, hand sketches, etc. For example, John Buhler, a successful Manitoba entrepreneur, keeps a picture of the major product produced by a firm he has unsuccessfully tried to take over pinned to his office wall as a constant reminder of this continuing goal.

It can also be useful to carry a notebook with you wherever you go. Anytime you come up with an idea, jot it in your notebook, and transfer it to your idea board when you get the chance.

2. Lifestyle Analysis

Entrepreneurs can utilize lifestyle analysis as a tool to generate further ideas for products and services. As an example, one important lifestyle pattern that could have relevance to a sporting goods manufacturer might be called a father's or mother's role as a "coach" for the remainder of the family. In this role, the parent is acting, thinking, and feeling like a non-professional practitioner of athletic coaching and training functions. Many of their concerns are the same as a professional coach, such as teaching the rules and fundamentals of a game. But because they are in their home environment they must deprofessionalize them. Profitable opportunities may be available to entrepreneurs who can capitalize on this parent's role as a coach—who can, in other words, get inside the role with them, act it out and emotionalize it with them. This process can lead to a commercial opportunities in sporting goods products and information services that they otherwise might not have seen, such as instructional videotapes, self-teaching training programs and specialized pieces of sporting goods for teaching and development purposes.

3. Observation and Evaluation

Once you have started developing ideas, try to look at each opportunity from different points of view. There are a number of variables you can consider when thinking about a product or service. The following list may help you in this process. It is not exhaustive, however; you will likely think of other issues. It is advisable to write them down so you can refer back to them later. But you might, for example, ask yourself:

How can I...

- —make it safer, cleaner, slower, or faster?
- —make it at home and save overhead expenses?
- —contract out to have other people make the product?
- —make it more convenient or inexpensive?
- —combine it with or add it on to other products or services?
- —make it easier to package, store, transport?
- —make it self-contained, portable, mobile, or disposable?
- —make it easier to use?
- —make it less expensive to replace, repair or reuse?
- —make it more attractive and appealing?
- —make it lighter, stronger, adjustable, thinner, or more compact?
- —add new features?
- —add new accessories?
- —make it multi-functional?
- —remove any irritating features or side effects?
- —improve its availability or distribution?

The next critical step, once you have identified a number of potential venture ideas, is to put

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each idea through some type of evaluation process. This will allow you to explore both your personal subjective beliefs and "hard" objective facts, so that you can make an informed decision as to whether to proceed further.

V

Assessing the Feasibility of Your Product or Service Idea

Generating ideas is a relatively simple procedure—the end-result of which is a number of potential business opportunities that may or may not have a chance of becoming successful ventures. Consequently, a critical task in deciding between several new business options is conducting an objective analysis and evaluation of each of the ideas and a thorough examination of their market and sales potential. It is essential that you subject your ideas to this analysis to find the "fatal flaws," if any exist, and they often do. Otherwise, the market place will find them after it's too late and you have spent a great deal of time and money.

Of course, no matter how exhaustive your evaluation, there is no guarantee of success. The challenge is to make an effort toward conducting a "complete" evaluation, knowing that at some point you will have to make a decision with incomplete information and less than scientific accuracy. This section will discuss some possible selection criteria that can be used in this evaluation, and suggest some procedures that will be useful in the evaluation process.

1. Personal Selection Criteria

Ultimately the criteria that you use in choosing a particular venture idea become very personal. These criteria may be very specific, such as requiring that the prospective business be located in a particular suburb of a city, or they can be more general. The step by step procedure illustrated below can help you sort out which of the ideas you are considering best meets your personal preferences and criteria. This procedure will also enable you to eliminate those ideas which do not meet your personal requirements from further consideration.

Step 1. List the various alternatives for a prospective new venture you have developed based on the various sources and techniques discussed in the first two sections of this publication. Indicate a number of specific businesses or types of businesses that you think you might want to own and operate.

This list might include, for example, such prospective businesses as:

—Food and Party Catering Service
—Electronic Games Arcade
—Quick-Print Photocopy Outlet
—Dry-Cleaning Store
—Tool and Equipment Rental Outlet
—Waterbed Store
—Pizza Restaurant
—Lawn Care Service
—Travel Agency
—Video Rental Store

Businesses I Would Want to Own/Operate

1. _____
2. _____
3. _____
4. _____
5. _____
6. _____
7. _____
8. _____
9. _____
10. _____

Step 2. Table 1 contains a number of general considerations and characteristics of a prospective business that you can use as a starting point in evaluating the fit of each of these business ideas with your personal criteria during this preliminary search process. As a first step consider each factor in the table and indicate your most desired limit or range on that factor or the upper limit acceptable to you in assessing various new business opportunities.

For example you might wish to start a business which ideally meets the following criteria or falls within the following limits:

a) located in Winnipeg or the community in which you presently live.
b) involves some degree of personal selling and provides an opportunity for regular interaction with other people.
c) can provide an annual income of at least $25,000 within the first 1-2 years and/or a

return of at least 20% on your investment.

d) builds on your past experience and permits you to work within an industry with which you have some familiarity.

e) involves a business that is held in high regard and viewed as making a positive contribution to the local community.

f) preferably would entail a regular work week of 8:00 a.m. to 5:00 p.m., 5 or 6 days a week with less than 20% out of town travel.

g) would require a maximum of $50,000 in start up capital.

h) would require only a small number of employees; ideally less than 3 or 4.

i) would have the possibility of continuing your involvement on a part-time basis at some point in the future.

The next stage in this evaluation is to indicate how important you feel each of these criteria is to you. For each item you have filled in indicate whether it is:

1 = Very important, a "must have"
2 = Desirable, but not essential
3 = Important, but could compromise
4 = Not really that important

In the above example you might feel that your criteria as expressed for items a), b), c) and g) are extremely important to you and would receive a rating of 1. Similarly items d) and i) are highly desirable, but not essential and would receive a rating of 2. Items f) and h) are criteria which it would be nice for the business to meet but upon which some compromise is possible while item e) is a factor which would be nice to have but is probably not really that important. The application of this process to the example is illustrated in Table 2.

Table 1

EVALUATION OF BUSINESS PERSONAL SELECTION CRITERIA

Criteria	Desired Range or Limit	Degree of Importance
a) Location of Business (city or province preferred, size of community)		
b) Type of Lifestyle or Workstyle (type of work, location of workplace, degree of involvement with other people, etc.)		
c) Impact on Standard of Living (desired return on investment and annual income expectations)		
d) Opportunity for Personal Growth and Development (ability to use formal education and personal expertise, contribute to society & generally grow as a person)		
e) Status and Prestige Associated With the Business		
f) Working Conditions (hours of business, length or work week, amount of travel required, commuting time, etc.)		
g) Total Amount of Capital Required to Start-Up		
h) Desired Size of Business (Number of employees)		
i) Other Considerations (list them)		

Table 2

EVALUATION OF BUSINESS PERSONAL SELECTION CRITERIA

Criteria	Desired Range or Limit	Degree of Importance
a) Location of Business (city or province preferred, size of community)	Winnipeg	1
b) Type of Lifestyle or Workstyle (type of work, location of workplace, degree of involvement with other people, etc.)	Personal Selling	1
c) Impact on Standard of Living (desired return on investment and annual income expectations)	>$25,000/yr.	1
d) Opportunity for Personal Growth and Development (ability to use formal education and personal expertise, contribute to society & generally grow as a person)	Familiar Industry	2
e) Status and Prestige Associated With the Business	Well Regarded	4
f) Working Conditions (hours of business, length or work week, a.nount of travel required, commuting time, etc.)	8:00 am.-5:00 p.m. < 20% travel	3 3
g) Total Amount of Capital Required to Start-Up	< $50,000	1
h) Desired Size of Business (Number of employees)	< 3 or 4 employ	3
i) Other Considerations (list them) Future Prospects	part-time potential	2

Step 3. Once you have completed both parts of Step 2, rank order each of these criteria and other factors you considered to be important in Table 3. Indicate for each criterion its relative importance to you in evaluating a business opportunity starting with 1 = most important, 2 = next most important, etc.

There are no "right" answers to these rankings. They are intended to reflect your personal preferences in selecting the right business opportunity. For our example our rank order of preference for each of the personal selection criteria might appear as shown in Table 3.

Table 3

RANK ORDERING OF PERSONAL SELECTION CRITERIA

Criteria	Rank Order
a) Location of Business	4
b) Type of Lifestyle or Workstyle	1
c) Impact on Standard of Living	2
d) Opportunity for Personal Growth and Development	5
e) Status and Prestige Associated With the Business	9
f) Working Conditions	7
g) Total Amount of Capital Required to Start-Up	3
h) Desired Size of Business	8
i) Other Considerations	6

Step 4. You might wish to discuss and review your assessment and rank order of these personal criteria with one or two people who know you very well. Use them to reality-test and refine your personal preferences and to make sure you are on the right track. See if they agree with your personal assessment.

Use this list of desired criteria to evaluate the relative attractiveness of each of the business oportunities you indicated you would like or would want to own/operate in Step 1. Place each business on your list in one of the columns in Table 4 based on your summary evaluation of its overall attractiveness.

For example, based on your overall assessment you might conclude that the businesses you previously indicated you might want to own and operate should be categorized as follows:

Very Attractive	Quick-Print Photocopy Outlet Tool and Equipment Rental Outlet Travel Agency
Somewhat Attractive	Dry Cleaning Store Waterbed Store Video Rental Store
Unattractive	Food and Party Catering Service Electronic Games Arcade Pizza Restaurant Lawn Care Service

This assessment will enable you to narrow and focus your search for a new venture. Even if you have already decided on a particular idea this exercise can be a useful way to test its fit with the criteria you feel are important.

Table 4

RELATIVE OVERALL ASSESSMENT OF BUSINESS OPPORTUNITIES

Degree of Relative Attractiveness		
Very Attractive	**Somewhat Attractive**	**Unattractive**

2. The Evaluation Process

You probably did not consider it too difficult to generate quite a number of potential new business ideas in the previous sections. However, upon further reflection and the use of some preliminary screening questions you undoubtedly have come to realize that many of these ideas either did not fit very well with your personal criteria or have no chance of being successful. Consequently, a critical task in selecting the right business opportunity is to conduct an analysis and evaluation of the probable success of the product or service idea.

a) Conceptual Evaluation

You should keep in mind that not all businesses are started on the basis of new or original ideas. Many, in fact, merely attempt to copycat successful ventures. To simplify matters all product and service ideas can be placed along a continuum according to their relative degree of innovativeness or may be placed into one of the following categories:

(i) *New Invention*. This is something created for the first time through a high degree of innovation, creativity, and experimentation. Examples are fibre optics, laser surgery, and computer bubble memories.

(ii) *Highly Innovative*. This term means that the product is somewhat new and as yet not widely known or used. Examples are cellular based telephone systems and rapid transit train systems.

(iii) *Moderately Innovative*. This refers to a product which is a significant modification of an existing product or service or combines different areas of technology, methods, or processes. Examples include microprocessors used to control automobile fuel injection systems or single-person cars. The term could also refer to such ideas as the redesign of bicycles to make them easier to ride by adults past their fitness prime, thus developing a new market.

(iv) *Slightly Innovative*. This term means that a small, yet significant, modification is made to an established product or service such as larger-scale or more exotic water slides.

(v) *Copycatting*. This is simply imitating someone else's business idea.

The degree of innovation inherent in a business idea has strong implications for the risk, difficulty in evaluation, and profit potential of the venture. Risk refers to the probability of the product or service failing in the marketplace. Evaluation is the ability to determine its worth or significance. Profit potential is the level of

return or compensation that you might expect for assuming the risks associated with investing in this business.

In general terms the following relationships tend to be true.

- New inventions are risky and difficult to evaluate, but, if accepted in the marketplace, can provide enormous profits.
- With moderately innovative and slightly innovative ideas the risks are lower and evaluation is less difficult, but profit potential tends to be more limited.
- In the copycat categroy, however, risks are often very high and profit potential tends to be quite low because there is usually little chance of succeeding with a complete imitation of someone else's idea. At best, businesses in this category usually means no or very slow growth and little opportunity for profit beyond basic wages.

b) Technical Evaluation

Each new product must also be subject to some form of technical analysis to insure that the benefits promised prospective customers will indeed be delivered. In developing a working prototype or an operating model some of the more important technical requirements to keep in mind include:

a) Keep it as simple as possible. Keep it simple to build; keep it simple to transport; keep it simple to maintain; and above all, keep it simple to use.

b) Make it flexible. There are many examples of products that were unsuccessful in the application for which they were originally developed but were redesigned to satisfy the needs of an entirely different market.

c) Build a product that will work as intended without failing. Quality assurance, eliminating the need for regular and constant service is becoming more important to consumers. They are more inclined than ever before to look for products that are durable, reliable, safe, and easily maintainable.

If a product does not meet these technical qualifications it should be re-worked until it does.

One key approach for testing a new product is to subject it to the toughest conditions that might be experienced during actual use. In addition to this kind of test there may be standard engineering tests to which the product will have to be subjected to receive Canadian Standards Association or Underwriters Laboratory certification. You might also undertake an evaluation of alternative materials from which the product might be made. Further assistance in conducting a technical evaluation can be obtained from the Industrial Technology Services of Manitoba Research Council in the Province of Manitoba.

3. Screening Your Product/Service Ideas

A number of evaluation techniques have been developed for use by entrepreneurs in their quest to find the right business opportunity. Some are quite simple; others are mechanistic and complex. One business, for example, might use a simple single criterion such as: "Because we already sell through manufacturer's agents any venture we get into must also use that method of distribution." Other entrepreneurs may concentrate on the anticipated financial returns from a prospective venture or want to be involved in a particular type of business, such as a sports related venture. In any event, the use of a comprehensive evaluation technique can help you critically analyze each of the product or service ideas you are considering.

The following method allows you to quickly screen the potential of a number of product-service ideas according to each idea's potential on a standard set of weighted characteristics. You may choose whatever evaluation criteria you feel are most important in applying the technique to your situation. As a result the evaluation is quite subjective. However, it still forces you to quantify your beliefs about each prospective venture. Each characteristic evaluated is assigned a value ranging from 1 to 4. The higher the value, the greater the potential of the idea on that characteristic.

For example: you might evaluate each of your opportunities on a number of characteristics similar to those illustrated below. These are merely indicative of the range of characteristics

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and values that might be used to evaluate each alternative. You should develop a set of criteria and a range of values that are most appropriate for your particular situation:

1. Expected ease of market entry
   - 4 Scattered competition that makes entry easy
   - 3 Mildly competitive entry conditions
   - 2 Strongly competitive entry conditions
   - 1 Entrenched competitors that make entry difficult
2. Estimated start-up time before sales are expected to increase rapidly.
   - 4 Less than six months
   - 3 Six months to one year
   - 2 One to two years
   - 1 More than two years
3. Estimated length of rapid growth phase
   - 4 More than three years
   - 3 Two or three years
   - 2 One or two years
   - 1 Less than one year
4. Expected time required to develop the product or service, test it with customers, and introduce it to the market.
   - 4 Less than six months
   - 3 Six months to one year
   - 2 One to two years
   - 1 More than two years
5. Investment required to develop the product or service idea, protect it, test it with customers and introduce it to the market.
   - 4 Less than $10,000
   - 3 $10,000 to $50,000
   - 2 $50,000 to $100,000
   - 1 More than $100,000
6. Estimated first year sales
   - 4 More than $500,000
   - 3 $200,000 to $500,000
   - 2 $100,000 to $200,000
   - 1 Less than $100,000
7. Capital investment payback period
   - 4 less than one year
   - 3 One to three years
   - 2 Three to five years
   - 1 Over five years
8. Expected pre-tax return on investment
   - 4 More than 35 percent
   - 3 25 to 35 percent
   - 2 15 to 25 percent
   - 1 Less than 15 percent
9. Sensitivity to variations in business and economic cycles.
   - 4 Impervious to business cycles or countercyclical
   - 3 Reasonably resistant to business cycles
   - 2 Normally subject to business cycles
   - 1 Strongly subject to business cycles
10. Protection for intellectual property
    - 4 Idea can be patented or trademark protected
    - 3 Not patented but sufficently proprietary to permit a long head start against competitors
    - 2 Limited protection only. Idea could be emulated by other firms with some effort.
    - 1 No real proprietary protection. Readily copied
11. Simplicity of production or manufacturing
    - 4 Only requires assembly. Sub-components can be purchased from other sources
    - 3 Limited manufacturing required. The production of some components can be subcontracted to other firms
    - 2 Requires relatively straight forward standard job shop facility
    - 1 Requires a sophisticated and complicated manufacturing process
12. Marketability of product or service
    - 4 Have a number of ready-made initial customers identifiable by name
    - 3 Can identify and describe the primary groups of customers for your product or service
    - 2 Really need to conduct a consumer survey to determine who my potential customers might be
    - 1 Have no idea of the approximate size or location of my potential market
13. Degree of innovativeness
    - 4 A new invention or idea that addressed a presently unserved customer need

3 Highly innovative and serves a market in which demand exceeds supply
2 Only moderately innovative but has a competitive advantage over similar products
1 Mainly copycatting in that it primarily initates other products and services already on the market

Only product-service ideas that pass this quick screen with a minimum score of 40 or so would be kept for further consideration.

To illustrate the application of this screen we might apply it to the three business opportunities we felt were "very attractive" in our summary in Table 4. Based on our subjective evaluation of the expected position of each business on the various characteristics we would develop a summary score for each one. For example, we might conclude that these businesses have the following scores upon application of the screen.

Characteristic No	Quick-Print Photocopy Outlet	Tool and Equipment Rental Outlet	Travel Agency
1.	4	4	3
2.	3	4	2
3.	4	3	3
4.	4	3	3
5.	3	2	3
6.	2	3	2
7.	4	3	4
8.	4	3	3
9.	3	4	2
10.	2	2	1
11.	3	3	4
12.	3	3	4
13.	2	2	1
Total Score	41	39	35

It would appear from this evaluation that the Quick-Print Photocopy Outlet is likely to be the opportunity with the most potential and should be considered further.

VI

Determining the Market Potential for Your Product or Service Idea

A serious miscalculation that many aspiring entrepreneurs commit is assuming that because their new product or service appeals to them it logically follows that other consumers will buy it as well. It is important to be aware of this tendency. This type of thinking is often reflected in what is known as the "2 percent" syndrome. This syndrome follows a line of reasoning such as, "The total market for a product is $100 million. If my firm can pick up just 2 percent of this market, it will have sales of $2 million per year."

There are, however, two things wrong with this line of reasoning. The first is that it may be extremely difficult for you to capture 2% of this market unless your business has a unique competitive advantage. The second is that a 2% market share might still be unprofitable since competing firms with greater market share may benefit from economics of scale and other cost advantages unavailable to your firm.

One approach for gaining some insight into the market potential that may exist for your product or service idea is to describe several potential customers for your product or service, in detail. These can be either acutal customers or hypothetical prospects. Indicate how you feel they would probably go about deciding whether to buy or not buy your business's offering. This estimate should also consider the likely frequency of purchase and the volume each prospect is likely to purchase over a period of time. Table 5 illustrates one process for determining the size of your business's potential market opportunity.

In implementing this process you should describe how you feel prospective customers will likely hear about the opportunity to buy your product/service, whether from a salesperson, an advertisement, or through a chain of middlemen. Estimates can then be made of how many of the people you have described as good prospects there are and, consequently, what your total sales volume might be. This procedure can be done in an "armchair" fashion with the use of some library references or through personal knowledge of similar businesses. The estimates of market potential developed using this method may be very crude. However, it is important that you think your way through such a process and not sidestep it in favor of simply hoping that a market will exist for your business idea.

This is merely one approach for estimating the size of your potential market. More detailed and comprehensive methods of market analysis are outlined in the publication "A Marketing Workbook" as well as the Small Business Management Systems publications for a "Retail Business Plan," "Service Business Plan," "Manufacturing Business Plan" and "Construction Business Plan" also available from the Business Resource Centre.

Table 5

STEPS IN DETERMINING POTENTIAL MARKET OPPORTUNITY

1. Describe several individuals, in detail, who would be likely prospects to purchase your product or service. Ask yourself questions such as: How old would these customers likely be? What types of activites would they participate in? Where would they live? What primary benefits are they looking for in using my product or service? etc.

2. How many of these people you have described as good prospects live in or travel through your trading area?

3. Describe how you feel these individuals would go about deciding whether or not to purchase your product/service versus a competitor's offering. Would potential customers be most concerned with price, convenience, product quality or some other factor?

4. How often would prospective buyers purchase your product or service: daily, weekly, monthly, other? Where would they look for it or expect to buy it?

5. How much (in dollars and/or units) would a typical customer purchase on each buying occasion?

6. How would your customers likely hear about your product offering: through newspaper, T.V. or radio advertisements, word of mouth, salespeople, middlemen, other?

7. From the above information, estimate your expected annual sales potential both in terms of dollars and number of units.

VII
Financial Analysis

1. Cost and Revenue Considerations

As the process of evaluating the conceptual and technical feasibility for your product or service idea takes shape, it is important to also consider the financial components of your business. The costs associated with operating your business may include labor, materials, rent, machinery, etc. Collecting potential sales and cost information should put you in a better position to make reasonably accurate financial forecasts that can be used not only as a check on the advisability of proceeding with the venture but also for raising capital, if required.

The financial analysis process begins by estimating the funds required to set up your business. These start-up financial requirements can be broken down into two components:

a) One-time expenditures that must be incurred before your business can open its doors. This includes such expenses as the purchase or lease of furniture, fixtures and equipment, utility deposits and fees, and pre-opening advertising and promotion expenses.

b) Operating expenses such as owner and employee wages, raw materials, rent, supplies and postage and interest expenses that must be covered until the business begins to show a profit. Many new businesses take several months or even years before they operate in the black. At the very least sufficient funds should be available to cover a minimum of two to three months' operation and provide a cash reserve for emergency situations.

Insufficient financing is a major cause of new business failure so you should be certain you have sufficient financing to cover both your estimated one-time and initial operating expenses.

The next step is to estimate your total expected revenue and expenses for at least the first year of operation of your business. This projected operating statement or pro forma income statement should show:

- your predicted sales volume for the first year of operation of your business.
- how much it will cost to produce or purchase the products you will sell.
- your fixed monthly operating expenses such as rent, utilities, insurance premiums and interest costs.
- your controllable monthly operating expenses such as advertising and promotion expenses, wages and salaries and delivery expenses.
- your expected net operating profit or loss.

Your next task is to bring your expected profit or operating loss closer to reality by developing a cash flow forecast and projecting your anticipated cash surplus or deficit at the end of each month of your first year of operation. While the income statement shows your expected total cash sales and credit sales due, a cash flow forecast estimates the total amount of cash you actually expect to collect each month and the actual bills that have to be paid.

One more financial statement should also be developed—a pro forma balance sheet listing what you forecast your business will own (Assets) minus what it will owe to other people, companies and financial institutions (Liabilities) to determine its net worth at any particular point in time.

All three of these statements are described in considerable detail along with comprehensive examples in a publication entitled "Guide to Small Business Financing" which is also available from the Business Resource Centre. Blank worksheets for developing this information for your prospective venture are contained in the Business Plan publications referred to previously.

2. Breakeven Analysis

As your preliminary financial forecasts begin to clarify the size of the potential opportunity you are investigating, there is one other key question to explore: what sales volume will be required for your business to breakeven? This breakeven point indicates the level of operation of the business at which your total costs equal your total revenue. The breakeven point is important because it indicates when your business can make a profit. If your sales level is less than breakeven, your business will suffer a loss.

VII

The breakeven point is affected by several factors—your fixed and variable costs, and your selling price. Fixed costs are those that remain constant regardless of your level of sales or production. Variable costs vary directly with the amount of business you do. For example, your rent is a fixed cost because it remains the same regardless of your level of sales. Your cost of goods sold, however, is variable because the amount you spend is directly related to how much you sell. Fixed costs typically include insurance, licenses and permits, property taxes, rent and similar expenses. Variable costs include supplies, salaries and wages, raw material, utilities, and delivery expenses. Variable costs are usually determined on a per unit or per dollar of sales basis.

The breakeven point can be determined algebraically. The basic formula is:

Breakeven Point (units) =

$$\frac{\text{Total Fixed Costs}}{\text{Contribution Margin per unit}}$$

where:

Contribution Margin per unit =
Selling Price per unit
—Variable Cost per unit

The value of breakeven analysis is that it can be used to determine whether some planned course of action—for example, starting a new business, opening a new store, or adding a new item to your product line—has a chance of being profitable. Once you have estimated the breakeven point for the action you are in a better position to assess whether such a sales volume can be achieved and how long it will take to reach it.

It is essential that you determine the breakeven level of operation for your business before you proceed very far with its implementation. Bankers and other financial people will expect to see this information as part of the financial documentation for your venture. In addition, if it appears that the necessary breakeven volume is not achievable, the business is probably destined to fail and should be abandoned before any money is invested and lost.

3. Downside Risk

Downside risk essentially refers to the issue: "how much can I possibly lose on my venture should it fail?" The potential losses in some businesses can wipe out virtually all the funds you have invested or personally guaranteed. This tends to be true in situations like a financial planning and counselling business, a travel agency or a hair salon where very little property or equipment is owned by the business.

In other situations such as manufacturing, construction,or real estate, there is usually an opportunity to sell the assets solely or partially owned by the business to recover at least a portion of your initial investment.

The way to explore this question is to consider alternative scenarios for different ways in which the business might fail and estimate the liquidation value of any residual assets. To the extent that this value falls short of their initial cost less any outstanding claims, you could lose that amount of money, plus the opportunity cost of the time and effort you spent in trying to develop the business.

Conclusion

Stage II of this self-evaluation guide has provided some powerful tools to help you in your search for and the generation and evaluation of potentially attractive new business ideas. The various methods and techniques described for these purposes will assist you in your systematic selection of an idea that will meet both your personal criteria and the technical and financial criteria set forth by knowledgeable business people. The use of these techniques will improve your chances of establishing a successful new business venture.

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